

CITY OF MESA

Review of Industrial Demand and Supply Study Completed by Elliot D. Pollack and Co.

March 8, 2001

Prepared by:

 **ERNST & YOUNG LLP**

Real Estate Advisory Services

Two N. Central Avenue, Suite 2300
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March 8, 2001

Mr. Keno Hawker
Mayor
City of Mesa
20 East Main Street
Mesa, AZ 85201

Dear Mr. Hawker:

In accordance with our engagement letter dated November 21, 2000, Ernst & Young LLP ("E&Y") has performed certain procedures related to a review of Industrial Demand and Supply Study prepared by Elliott D. Pollack and Company ("Pollack") on September 29, 2000. Our key findings and conclusions are presented in the attached report and subject to the assumptions and limiting conditions which follow.

This report is intended solely for the use of Mesa ("Client") and should not be used by those who did not participate in the formation of the procedures. The Client understands that any omissions or misstatements of material information may materially affect the analysis.

The approach and methodologies applied in our report do not comprise an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the fair presentation of financial statements or financial information presented in accordance with generally accepted accounting principles. The scope of work in this engagement is not to be construed as an audit or review of any of the financial information as defined by the American Institute of Certified Public Accountants.

Finally, neither our report, nor its contents, nor any of our work were intended to be included and, therefore, may not be referred to or quoted in whole or in part, in any registration statement, prospectus, public filing, private offering memorandum, loan agreement or other agreement or document without our prior written approval, which may require that we perform additional procedures, nor can it be used for any purpose other than as expressly stated in this report.

Sincerely,

Ernst & Young LLP

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Assumptions and Limiting Conditions

The advisory services and report prepared by E&Y will be subject to the following assumptions and limiting conditions. The Client recognizes that:

- For any land uses proposed or analyzed, E&Y does not represent that the land use will be a conforming use or that the zoning can be changed to an appropriate zoning code for that use.
- E&Y has not reviewed any environmental reports on the subject property and has not factored into its analysis any adverse impact or limitations pertaining to environmental issues or the costs of any related remedial efforts.
- It is our understanding that this advisory report is for your internal planning. While we realize the engagement is subject to public disclosure laws, neither our report, nor its contents, nor any of our work were intended to be included and, therefore, may not be referred to or quoted in whole or in part, in any registration statement, prospectus, public filing, private offering memorandum, loan agreement or other agreement or document without our prior written approval, which may require that we perform additional procedures, nor can it be used for any purpose other than as expressly stated in this report.
- The report is intended for the Client's internal use and due diligence only. We are acting as part of the Client's overall due diligence team.
- Estimates of future events described in the report will represent general expectancy concerning such events as of the reporting date. Since our estimates are based on assumptions which are inherently subject to uncertainty and variation depending upon evolving events, we do not represent them as results that will be actually achieved. Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved may vary materially from the estimated results.
- E&Y is not obligated to update the due diligence report for events subsequent to the date of our report. All services subsequent to delivery of the report, including meetings, testimony or deposition in court or before any governmental agency, will be provided at our standard billing rates plus any expenses.
- Except as specifically stated to the contrary, the advisory report will not give consideration to the following matters to the extent they exist: (i) matters of a legal nature, including issues of legal title and compliance with federal, state and local laws and ordinances; and (ii) environmental and engineering issues, and the costs associated with their correction. The user of the advisory report will be responsible for making his/her own determination about the impact, if any, of these matters reported.

- The reported advisory observation(s) will represent the considered judgment of the identified advisors based on the facts, analyses and methodologies described in the report. Our workpapers will be available for your review.
- All direct and indirect written information supplied by Mesa, their agents and assigns, concerning the market is assumed to be true, accurate and complete; additionally, information identified as supplied or prepared by others is believed to be reliable. However, no responsibility for the accuracy of such information is assumed.
- This report is intended to be read and used as a whole and not in parts.
- None of the contents of this report shall be disseminated to the public through advertising media, news media, sales media, Security Exchange Commission, or any other public means of communication without the prior written consent and approval of E&Y.
- With respect to our analyses, our work did not include an analysis of the potential impact of any unexpected rise or decline in local or general financial markets or economic conditions or technological changes.
- E&Y's liability to Mesa, regardless of whether such liability is based on breach of contract, tort, strict liability, breach of warrants, failure of essential purpose or otherwise, under this Agreement or with respect to the services shall be limited to the amount actually paid by Mesa to E&Y under this Agreement. If E&Y is working on a multi-phase engagement for the Mesa, E&Y's liability shall be limited to the amount paid to E&Y for the particular phase that gives rise to the liability.

Scope of Assignment

The real estate advisory services group at Ernst & Young completed the following policies and procedures for the City of Mesa engagement.

- Read the Pollack report - Industrial Land Demand and Supply Study, dated September 29, 2000.
- Obtained and analyzed the Mesa General Plan and Existing Land Uses on computer CDs.
- Reviewed a copy of the Williams Gateway Master Plan.
- Met with certain representatives of the city of Mesa.
- Commented on key assumptions utilized in the Pollack report.
- Researched and analyzed key assumptions in the Pollack report.
- Critiqued key assumptions in the Pollack report.
- Prepared an analysis of the Mesa industrial and office vacant land supply.
- Prepared this report of our findings.

Pollack Report Review Comments

The first step in the engagement was to read the September 2000 report prepared by Pollack and comment on their methodology. We identified the following key assumptions in the Pollack report.

Land Supply Base

There were a number of important considerations that the Pollack report did not take into consideration in regards to the derivation of the industrial supply base in Mesa.

The Pollack report utilized a land supply base comprised of GI (General Industrial) and CP (Commerce Park) planned acreage as identified in the 1996 General Plan in estimating the approximately 23,350 industrial acres. This base includes vacant and improved industrial land in the City of Mesa.

Pollack did not deduct the acreage already improved with buildings from his base of available land supply.

A major oversight in the Pollack report was that it included CP and GI land uses in the supply base, but only industrial demand for land in Mesa. These zoning designations allow industrial, office (low, mid and high-rise, flex and back) and support retail uses. Leaving out the office demand, but including the supply of office land is misleading.

Pollack should have deducted the following items from their base number:

- Land rezoned from CP or GI uses and developed for other commercial or residential uses since the 1996 general plan;
- Land which will be developed for support retail uses (restaurants, service/convenience stations, business services, etc.), which Mesa representatives estimate will occupy at least 10% of developable CP and GI designated areas;
- Land for salvage yards, open storage, construction yards, equipment yards, open lots, plant nurseries, landfills, utilities and other land-type uses. We are unaware of any statistics on the quantity of these uses existing in Mesa, but have deducted 5% of the developable acreage as a conservative estimate for these uses.
- Undevelopable land located north of, or in, the Salt River which is only suitable for sand/gravel operations;
- Land necessary for the airport right-of-ways and runways; and
- Land leased by Talley from the State.

Neglecting to deduct the preceding items from the available supply base grossly overstates the vacant developable acreage.

We should point out that while we deducted 10% of the developable CP and GI designated land for other non-office and industrial uses, we did not apply a deduction for conversion of CP and GI land uses to other commercial uses such as big box and neighborhood retail, hotels and other recreational properties. Our 10% adjustment is simply for service retail uses, which are allowable in the CP and GI designations. Therefore our estimates are conservative and assume no future CP and GI designated land changes to other uses.

Land Demand Base

Most of the office development which will occur in Mesa over the next 20+ years will be on CP designated land. However, in their demand projections, Pollack only included demand for industrial buildings (manufacturing, R&D and warehousing).

The most significant future change to Mesa area commercial land demand is the extension of the metropolitan freeway network through the city by 2007. These freeways will open up areas previously not suitable for extensive commercial development, similar to what has occurred along the 101 freeway in Tempe, Chandler and Scottsdale.

Due to the changing freeway patterns, emerging regional employment center at Williams Gateway Airport and continued congestion on Freeway 60 in the future, we believe significant flex office, back office and standard two story office product will move into Mesa, similar to what has already happened in Tempe and Scottsdale. As these competing areas build out, Mesa will become an even more attractive location for office uses.

The Pollack report should have included demand for office, industrial and support retail in their estimates, instead of only industrial demand land uses.

*Job Ratio on CP and GI
Planned Land*

Pollack utilized a ratio that 25% of all jobs in Maricopa County are located in industrial buildings. They should have used a figure of 48% of all jobs are located on CP, GI and O designated land which includes office (28%) and industrial (20%). Pollack significantly understated the demand for CP and GI designated land.

Residential Buildout

Pollack assumed that residential build out of Mesa in about 20 years would equate to the end of demand for commercial development in the city. This assumes that everyone working in Mesa would have to live in Mesa. This is obviously misplaced logic or Tempe would not be experiencing any new commercial development as it has essentially been fully built out in terms of residential land over the past few years.

We conducted an analysis which illustrates this point. Based on the number of new residents to Tempe from 1996 to 1999, the City should only have absorbed 175 acres of office and industrial land. Based on actual absorption of building space over the period, we estimate the city actually absorbed 671 acres of land, which is almost 4 times the amount of land indicated by the number of new residents. Clearly, the city is attracting employees that live in other cities and work in Tempe. The table on the following page summarizes our analysis.

The Pollack assumption does not consider that Williams Gateway will likely become a major regional employment center and the impact of the freeway network on previously inaccessible areas. A review of area general plans indicates that the Williams Gateway Airport/GM Desert Proving Ground area is a potential area for a major employment center in the Far East Valley. The other office and industrial acreages in the region are generally too small and fragmented to serve as major employment centers.

Estimate of Office and Industrial Acreages
City of Tempe
1996-1999

ASSUMPTIONS	
Industrial FAR	0.2
Office FAR	0.5
Employees per Resident	0.91
Industrial Employees as Percent of Total Jobs	25%
Employees per Industrial Acre	14
Office Employees as Percent of Total Jobs	25%
Employees per Office Acre	75

<u>Acreage estimates based on actual building construction</u>		1999	1998	1997	1996	Total
New Industrial Supply (SF)		743,512	1,062,540	1,168,231	1,396,168	
New Office Supply (SF)		1,575,003	764,661	601,179	311,158	
Estimate of New Industrial Acres (Ind SF x FAR)		85	122	134	160	502
Estimate of New Office Acres (Office SF x FAR)		72	35	28	14	149
Office and Industrial Acres Required						651
<u>Acreage estimates based on number of new residents</u>						
New People		367	2,922	2,704	3,102	
New Employees		334	2,659	2,461	2,823	
New Industrial Employees		83	665	615	706	
Industrial Acres Required		6	47	44	50	148
New Office Employees		83	665	615	706	
Office Acres Required		1	9	8	9	28
Office and Industrial Acres Required						175

Source: City of Tempe, EY Research

Developable Acreage

Pollack utilized building demand figures to estimate demand for land, assuming a market based site coverage ratio. This site coverage figure assumes net developable acreage and does not include a deduction for streets, sidewalks, landscaped areas, water retention and undevelopable acreage. These areas would not contain developable building square footage and should be deducted from the supply base. Based on previous work we have completed on commerce and business parks, we estimate a deduction of at least 15% would be required for these land uses before individual building sites could be developed. The following table summarizes the vacant potential office and industrial land supply base in Mesa. These adjustments will be described in more detail in our supply and demand report.

The following table illustrates how the 11,632 available vacant developable office and industrial acreage in the City of Mesa planning area was calculated:

City of Mesa - Vacant Office/Industrial Land Based on the General Plan		
<i>Vacant Office and Industrial Land</i>		<i>Acres</i>
CP		5,662
GI		6,269
O		56
<i>Total Vacant Land</i>		<i>11,987</i>
<i>Adjustments</i>		
Undevelopable/Unavailable		(943)
Airport (Developable)		522
GM Proving Grounds		5,052
<i>Total Adjustments</i>		<i>4,631</i>
<i>Total Developable Acreage</i>		<i>16,618</i>
<i>Less</i>		
Support Retail Uses	10%	(1,662)
Open Storage Lots	5%	(831)
Infrastructure/Public ROW/Open Space	15%	(2,493)
<i>Deductions</i>		<i>(4,986)</i>
<i>Total Developable Acreage</i>		<i>11,632</i>

It should be noted, we did not deduct any acreage currently planned for CP, GI or O land uses that could be developed for other uses (we did deduct support retail uses on the acreage). The land use map is based on anticipated future events, but as has historically been the case, some of the CP, GI and O designated land will be developed with neighborhood retail, hotels, churches, parks, schools, etc. These reclassification deductions were not applied, we assumed every acre of CP, GI and O designated would be developed with those uses in quantification of Mesa's available supply. This conservatively over-estimates by some percentage, the supply of vacant and available future office and industrial land.

*Ernst & Young Office and
Industrial Supply Base
Estimate*

We evaluated the proposed and use of every parcel in Mesa, based on the 1996 General Plan, updated for any land use changes. We deducted all developed parcels from this figure and all undevelopable or unavailable parcels. These parcels include parcels on the north side of Salt River and Talley/TRW properties under long-term ground leases. We deducted 15% from the gross acreages for public right-of-ways, water retention, etc. Finally, we deducted 10% for support retail uses that would be developed on CP or GI land, based on minimum estimates from the Mesa planning department. The following net developable acreages are indicated for Mesa, based on the existing General Plan.

The Pollack report indicates an industrial land supply base of 23,350 acres. Ernst & Young estimates an office and industrial land supply base of 12,254 net developable acres in Mesa, based on the 1996 General Plan and necessary adjustments. Our figure includes the entire GM Proving Grounds property.

*Other Developable Office/
Industrial Acres in
Region*

The existing office and industrial land supply was also analyzed for the other communities in the region. Two spatial databases were acquired from MAG. They contain the general plan land uses and existing land uses for Maricopa County and Apache Junction. They were created in 1996. The cities of Gilbert, Queen Creek and Apache

Junction were also analyzed and created in 1996. Parcels that were classified as Business Park, Industrial, and Warehouse/Distribution were classified office/industrial. These parcels were overlaid with the existing land use model in order to determine the potential supply of vacant office and industrial land.

Assumptions

The following parcels were removed from the regional vacant office/industrial land model:

- Apache Junction - All office/industrial land was removed from the model. These parcels are currently State Land and are not available for development. We also excluded potential residential land on state land which would increase the demand estimates for office/industrial land due to more employees in the region. To be consistent, we excluded the supply of office/industrial and residential land uses on unplanned state land.
- Southeast corner of Country Club and Baseline - 50% of this land was removed from the model. A number of these parcels have been development since the data was created in 1996.
- Gilbert Gateway Plan - This amendment to Gilbert's General Demand adjusted Gilbert's industrial acres by deleting 270 acres.

The subtotal of 6,631 acres is subjected to the same coverage ratios as the City of Mesa model with the following exception: 20 percent was subtracted for future roads and other infrastructure. This number is higher than the 15 percent used in the Mesa because the MAG land use database has existing roadways removed from the database.

The following table illustrates how the 4,135 vacant developable office and industrial acres in the Gilbert, Queen Creek, and Apache Junction planning areas were calculated. There is no industrial land planned for unincorporated Pinal county and, therefore, is not included in this model.

Other Vacant Office/Industrial Land Located in Gilbert, Queen Creek, Apache Jct.	
Total Available	9,519
Adjustments	
50% of SEC CC/Baseline (Build out since 96)	(423)
Gilbert Gateway Plan Changes	(270)
Apache Jct (Uncommitted State Land)	(2,465)
Gross Office/Industrial Acreage	6,361
Less:	
Support Retail Uses 10%	(636)
Open Storage Lots 5%	(318)
Infrastructure/ROW/Open Space 20%	(1,272)
Deductions	(2,226)
Total Developable Office/Industrial Land	4,135

Overall Conclusion

As a result of the previously discussed oversights contained in the Pollack report, they seriously understate the office and industrial land demands in the Mesa MPA over the next 3 decades and overstate the supply of vacant acreage available for commercial development. Based on the assumptions outlined in this review, we believe the Pollack report overstates the planned office and industrial developable land supply base in the Mesa MPA by over 100%. The following table illustrates net developable office and industrial land supply in the East Valley.

Planned Office and Industrial Land in Mesa and Far East Valley	
Area	Acres
City of Mesa	11,632
Remainder of Far East Valley	4,135
Total Planned Supply	15,767

In Phase II of our assignment, we will estimate the office and industrial demand in the Far East Valley.